Supreme Court, U.S.
FILED
MAY 28 2010
OFFICE OF THE CLERK

No. 09-1140

IN THE

Supreme Court of the United States

BANK OF GUAM,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

REPLY BRIEF

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WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

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REPLY BRIEF

Nowhere in its opposition does the government address – let alone defend – the Federal Circuit's misguided holding that "the terms and duties of any express contract [with the government] are defined by the federal laws and regulations pertaining to [government bonds]," Pet. App. 14a. Nor does the government explain how the holding below, which would allow the government to induce bond purchases through empty and unenforceable commitments, can be reconciled with this Court's decision in *United States* v. *Winstar Corp.*, 518 U.S. 839 (1996) (plurality opinion).[1] Instead, the government offers a laundry list of alternative justifications for the judgment, none of which was actually addressed by the Federal Circuit and all of which lack merit.

Because the government is unwilling and unable to defend the Federal Circuit's erroneous holding on its own terms, the Court should vacate and remand for further proceedings. At the very least, certiorari should be granted, and the case heard on the merits.

I. THE GOVERNMENT DOES NOT DEFEND THE DECISION BELOW, WHICH PRESENTS A CLEAR CONFLICT WITH THIS COURT'S PRECEDENT.

The rule of *Winstar* is clear and uncontested: The United States is liable for contract damages when it repudiates an agreement with private parties, even when the government's contractual commitments are inconsistent with the terms of a federal statute. See

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[1] While *Winstar* was a plurality opinion, see *Winstar*, 518 U.S. 839, seven members of the Court joined in the relevant aspect of the holding. *See id.* at 919-24 (Scalia, J., concurring in the judgment).

Winstar, 518 U.S. at 885 (Souter, J.). The holding below directly contradicts this inviolable principle. According to the Federal Circuit, "the terms and duties of any express contract [with the government] are *defined by* the federal laws and regulations" – here the federal tax statutes – pertaining to government bonds. Pet. App. 14a-15a (emphasis added).

This holding was not merely inconsequential language in the court's opinion. To the contrary, it was the core of the court's reasoning and the central premise for its conclusion that, "in determining the duties required by the express contract between the Bank and the United States, we look to the federal laws and regulations governing the [government bonds.]"[2] Pet. App. 15a. It was also the basis for the court's decision to ignore the allegations and evidence of the government's repeated commitments that the bonds were not subject to the Guam Territorial Income Tax ("GTIT"). See *id.* at 19a.

Yet, the government makes no effort to defend this pivotal element of the Federal Circuit's decision. Not one word of the Brief in Opposition pertains to the Federal Circuit's actual holding. Instead, the government asserts (without even citing the relevant passage of the opinion) that the Federal Circuit simply offered a "modest" "descriptive statement" of the "tax treatment of USGOs." Opp. 13. But that assessment is belied by the fact that, in support of its *legal* conclusion, the Federal Circuit relied on cases that addressed preemption and choice of law, rather

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[2] As in the petition, for simplicity the Bank here uses the term "bonds" to refer to treasury bills, bonds, and notes, which the government labels in its Brief in Opposition as "United States . . . government obligations (USGOs)." Opp. 3.

than the "tax treatment of USGOs." See *Free* v. *Bland*, 369 U.S. 663 (1962); *Bank of Am. Nat'l Trust & Sav. Ass'n* v. *Parnell*, 352 U.S. 29 (1956); see also *United States* v. *Chandler*, 410 U.S. 257, 260-61 (1973) (per curiam) (question of federal estate tax). The Federal Circuit's holding was not a mere "descriptive statement," let alone a "modest" one, and it was not limited to the "tax treatment" of USGOs.

Indeed, there is nothing in the reasoning of the court's opinion that would even limit its broad reach to government bonds. The Federal Circuit did not enunciate any rule of law that would place government bonds in a *sui generis* realm distinct from all other government contracts. The court's conclusion could apply just as easily, and just as erroneously, to any other government contract, allowing the government to breach its promises without recourse.

But even if the court's decision could somehow be limited to bonds, it would still warrant vacatur and remand. Considering the size of the United States' debt (nearly $13 trillion and growing exponentially to deal with the current economic crisis), the Federal Circuit's unprecedented holding can hardly be described as having "little prospective significance." Opp 9, 17. And the government makes no effort to defend the court's holding at all – an omission that is all the more glaring given that the holding was the express subject of the Bank's petition. See, *e.g.*, Pet. 3, 8, 12-13 (citing Pet. App. 14a).

Absent intervention by this Court, the Federal Circuit's erroneous and unsupportable holding will remain the law of the land. Claims for contractual damages (exceeding $10,000) against the United States are exclusively heard by the Court of Federal Claims and then subject to review only by the Federal Circuit. See 28 U.S.C. §§ 1491(a)(1) & 1295(a)(3).

Even if the holding below affects only the several trillions of dollars worth of government bonds, certiorari is necessary.

II. THE GOVERNMENT'S ARGUMENTS TO THIS COURT DID NOT FORM THE BASIS OF THE FEDERAL CIRCUIT'S DECISION AND IN ANY EVENT LACK MERIT.

Instead of defending the decision below, the United States offers alternative justifications for the outcome, not one of which was discussed by the Federal Circuit. That alone is reason enough to vacate and remand. See *Lawrence ex rel. Lawrence* v. *Chater*, 516 U.S. 163, 166-67 (1996) (per curiam) (explaining that this Court has exercised its discretion to grant, vacate, and remand in light of "confessions of error or other positions newly taken by the Solicitor General"). If the government wishes to offer these alternative arguments on remand, it is free to do so. But none of these arguments should be the basis for sustaining an erroneous and far-reaching decision that the government has now elected not to defend before this Court. In any event, none of the government's new arguments is substantial.

1. First, the government disputes the factual premise of the Bank's complaint – that the government made a contractual commitment to the Bank that interest income on government bonds would be exempt from the GTIT. But the government ignores that, for decades, it repeatedly represented that the GTIT did not apply to the income earned on government bonds. See Pet. App. 76a-97a. The government also ignores the procedural posture of this case, which arises on a motion to dismiss. Once the motion to dismiss is properly denied (which only review by this Court can accomplish at this point),

the government can offer evidence, if any, contesting the Bank's allegations. But at this Rule 12(b)(6) stage, the government cannot disregard the complaint's well-pleaded allegations regarding the contract and the promises on which the Bank reasonably relied. See Pet. App. 63a-65a ¶¶ 6-9; see also *Bell Atl. Corp.* v. *Twombly*, 550 U.S. 554 (2007).

Finally, it is no response that the bond covenant mirrors language in the regulations, see, *e.g.*, 31 C.F.R. §§ 309.4, 340.3 – a point which the Bank itself raised in its petition, Pet. 5. (Indeed, now that the bonds are no longer issued in paper form, the regulations are the sole source of the government's commitment.[3] *Id.*) For decades, the government construed that regulatory language to mean that the bond income would not be subject to the GTIT; and the Bank understood and relied on the government's construction. Pet. App. 64a-65a, ¶ 9. The government offers no support for its newfangled view that the regulations were instead intended simply to reassert the rights and obligations of the federal tax

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[3] Contrary to the government's assertion, the Bank did not "argue[] in the court of appeals that 31 U.S.C. 3124," the tax statute at issue in *Gumataotao* v. *Director of Department of Revenue & Taxation*, 236 F.3d 1077 (9th Cir. 2001), "suppl[ies] some of the terms of the contract governing a USGO," let alone the terms at issue here. Opp. 10. The relevant statutory provisions are 31 U.S.C. §§ 3104 and 3121, which authorized the Treasury to enter into the bond contracts. *See also* Pet. 11 n.5.

Further, as noted in the petition (at 14 n.8), it is of no moment that "[t]he USGOs . . . expressly reference the statutory limitation on their tax-exempt status set forth in 31 U.S.C. § 3124" Opp. 11. That limitation pertains only to "(1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and (2) an estate or inheritance tax." 31 U.S.C. § 3124. It has nothing to do with the issues in this case.

statutes. And, it is difficult (to say the least) to square this view with the government's repeated representations regarding the GTIT that *post*-date the Ninth Circuit's decision in *Bank of America, National Trust & Savings Ass'n* v. *Chaco*, 539 F.2d 1226, 1226-27 (9th Cir. 1976) (per curiam).[4] *After* "the Ninth Circuit . . . addressed the question whether the GTIT constitutes '[t]he imposition by a[] State of a tax for purposes of 12 U.S.C. 548,'"[5] the government continued to represent that "the pertinent regulations . . . exempt [bonds] from taxation by possessions," including Guam. Pet. App. 78a; see also Pet. 5-6, 12 n.6. The Bank relied on these representations, Pet. App. 64a-65a, ¶¶ 8, 9, and purchased hundreds of millions of dollars worth of the bonds. The government should not be permitted to abandon its contractual commitment.

2. Next, the government contends that the Bank waived its ability to present any extrinsic evidence. Opp. 11. This argument, too, must fail. At the motion to dismiss stage, there is no obligation to present *any* evidence, so it is no surprise that the government fails to cite support for its novel proposition that, on a Rule 12(b)(6) motion, a party can waive its right to provide documentary evidence.

The Bank's well-pleaded complaint alleges the terms of the contract and reliance on the government's express representations about what those

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[4] As explained in the petition, the Bank believes that the government is over-reading *Bank of America*. Pet. 13 n.7. But the point is, even under the government's interpretation, the tax statutes do not define the regulations or the bond contracts.

[5] Opp. 3 (alteration in original); *see also id.* at 16 ("*Bank of America* . . . held that the GTIT is imposed by Congress and therefore is not a tax imposed by Guam").

terms mean. Pet. App. 63a-65a, ¶¶ 6-9. Documentary evidence is not necessary to survive a Rule 12(b)(6) motion, but here it nonetheless confirms the Bank's allegations.[6] The government should not be permitted to disregard its long string of representations of what the bond covenants in the regulations meant. See *id.* at 76a-97a.

3. Well aware that the Federal Circuit failed even to cite *Winstar*, the United States now argues that *Winstar* is distinguishable: whereas *Winstar* dealt with a post-performance statutory enactment, the relevant statute in this case was enacted before the Bank purchased the bonds. As explained in the petition, however, this is inconsequential. Pet. 16-17. Under *Winstar*, contract rights can exceed statutory rights, and the government is liable much like any private party that breaches a contractual commitment. See also *Lynch* v. *United States*, 292 U.S. 571, 579 (1934) ("When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.") The Bank relied on decades of representations by the government regarding its promise that bond income would not be subject to the GTIT, and the contracts expressly exempted the bonds from "all taxation *now or hereafter* imposed on the obligations or interest herein by . . . any of the possessions of the United

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[6] The government itself seeks to rely on extrinsic evidence to support its argument. Attempting to undermine the Bank's claims regarding intent, the government notes that the Bank declared income earned on government bonds as taxable on several tax returns. Opp. 4. But the government fails to note that, after the Bank recognized its error and filed a claim for a refund, Guam granted the claim, thereby acknowledging that the interest was not taxable. *See* Supp. App. 1a-5a.

States." Pet. App. 75a (emphasis added). The fact that the GTIT was enacted in 1950 does not exonerate the United States from the contractual damages *Winstar* permits. Nothing in *Winstar* turns on the timing of Congress's enactment. A breach is a breach, and the Bank is entitled to damages for the government's failure to live up to its end of the bargain.

At any rate, the Federal Circuit did not distinguish *Winstar* based on any of these facts. Indeed, despite extensive briefing of that case – the core of the Bank's argument – *Winstar* was never even mentioned in the court's decision. The government is free to argue its view of *Winstar* on remand, but the court's erroneous decision – which the government does not defend – should be vacated.

4. The United States also argues that any government promise regarding the applicability of the GTIT is unenforceable because "no provision of law . . . 'clearly and unmistakably' authorizes the Department of the Treasury to issue USGOs that are exempt from the GTIT." Opp. 14-15. Yet, neither the Court of Claims nor the Federal Circuit ever questioned whether statutory authority existed for the executive branch to enter into the contracts at issue – and for good reason. As noted in the petition, the executive branch unmistakably had such authority under 31 U.S.C. § 3104(b) ("The Secretary [of the Treasury] may prescribe conditions for issuing certificates of indebtedness and Treasury Bills . . . .") and 3121(a)(7) (granting the Secretary of the Treasury the authority to prescribe "other conditions" as needed when selling government bonds). See also Pet. 11 n.5. The government never explains why these statutory provisions are insufficient.

Moreover, the government offers no basis to apply the unmistakability doctrine in the first place. That doctrine concerns contracts that have "the effect of extinguishing *pro tanto* an undoubted power of government." *Home Tel. & Tel. Co.* v. *City of Los Angeles*, 211 U.S. 265, 273 (1908); see also Opp. 14. The bond contracts at issue do no such thing. Rather, the United States simply agreed that its bonds should not be subject to a tax assessed and collected *by Guam*. Such a covenant does *not* "deprive the Government of money it would otherwise be entitled to receive." *Winstar*, 518 U.S. at 882 (Souter, J.).

5. Finally, the United States contends that the courts should not infer a tax exemption unless the agreement will "'admit of no other reasonable interpretation.'" Opp. 15. As explained in the petition, however, this argument played no role in the Federal Circuit's decision below, and, in any event, lacks merit. Pet. 15, 17. Only one understanding existed at the time the Bank purchased the government's bonds: that the bond income would be "exempt" from the GTIT. See Pet. App. 64a-65a, ¶ 9; see also *id.* at 76a-97a. In light of this singular understanding at the time of contracting, the only reasonable interpretation of the agreements is that the parties intended that the GTIT would not apply to income earned on the bonds.

This interpretation is consistent with the ordinary meaning of the contract, which, as noted, exempts the bonds from "all taxation now or hereafter imposed on the obligation or interest herein by . . . the possessions of the United States." Pet. App. 75a. The government now disputes the meaning of the word "imposed," but the term is commonly construed to mean "apply," "levy," and "charge." See, *e.g.*, *Webster's Third New International Dictionary of the*

English Language 1136 (1993); *Black's Law Dictionary* 759 (7th ed. 1999); see also *Lewyt Corp.* v. *Comm'r*, 349 U.S. 237, 239-40 (1955). That is how the parties construed it for decades, and the Bank relied on that construction and the government's repeated representations when it purchased hundreds of millions of dollars in government bonds. Pet. App. 64a, ¶ 8. Guam, and only Guam, applies, levies, and charges the GTIT. Despite the terms of the bargain, Guam collects the GTIT. The government should not be allowed to shirk its contractual commitments.

CONCLUSION

For the foregoing reasons, and those set forth in the petition, the petition for a writ of certiorari should be granted, the decision below vacated, and the case remanded for further proceedings. In the alternative, certiorari should be granted, and the case heard on the merits.

Respectfully submitted,

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* Counsel of Record

May 28, 2010

SUPPLEMENTAL APPENDIX

SUPPLEMENTAL APPENDIX A

DISTRICT COURT OF GUAM
TERRITORY OF GUAM

[APR 24 2001]

CIVIL CASE NO 01-00016

BANK OF GUAM,

Petitioner,

vs

DIRECTOR OF DEPARTMENT OF REVENUE & TAXATION,

Respondent

VERIFIED PETITION IN TAX CASE.

* * * *

[5] (3) During the tax years 1978, 1979, and 1980, petitioner erroneously reported interest income on Treasury obligations as an item of taxable income on its returns filed with the Department. However, in or about 1981, petitioner was informed that interest income on Treasury obligations was not taxable by the Department under the G T.I.T. Thereafter, petitioner submitted to the Department a refund claim for the 1978, 1979, and 1980 tax years, basing its claim on the understanding that interest income on Treasury obligations was not taxable by the Department. The Department approved petitioner's refund claim, thereby confirming that such interest was not taxable. The overpayments previously made by petitioner resulting from the inclusion of interest

income on Treasury obligations were either refunded to petitioner by the Department or credited against taxes owed by petitioner to the Department in subsequent tax years. True and correct copies of letters pertaining to this refund dated September 20, 1985 and August 25, 1986 are attached hereto as Exhibits 2 and 3[.]

* * * *

SUPPLEMENTAL APPENDIX B

A.A. LEON GUERRERO
SR. VICE PRESIDENT/
GENERAL
ADMINISTRATION
[logo]
MEMBER OF THE
FEDERAL
DEPOSIT INSURANCE
CORP.

Bank of Guam
"The People's Bank"
P.O. Box BW
Agana, Guam 96910

Tel: 472-8865 Thru 8867
472-8971 Thru 8979

September 20, 1985

Dave Santos
Director
Department of Revenue & Taxation
Government of Guam
Agana, Guam 96910

Dear Dave:

As you are probably aware the Bank of Guam as of December 31, 1984 has a tax receivable due from the Government of Guam of approximately $709,163.00 (Principal) plus interest. At the present time, we are finalizing our computation of the interest which involves various rate through out the period in question.

This amount due has been in our books for quite a while and I'm sure you can appreciate our desire to try and initiate its liquidation. We are aware, however, and are sensitive to the Governments present cash flow tightness and are willing to agree to payment in four (4) quarterly installments as follows:

October 1, 1985	Principal payment of $236,388.00
December 31, 1985	Principal payment of $236,388.00
March 31, 1986	Principal payment of $236,387.00
June 30, 1986	The balance of the interest due for the entire period involved.

I will be appraising your office of the interest that would be due at that period given the senario of repayment herein as structured above.

We do appreciate your consideration and assistance on this matter and if there should be any difficulties in meeting the above request, please let us know immediately. Looking forward to a final resolution on this matter.

Please indicate your acceptance by signing on the spaces provided below.

Sincerely,

/s/ [illegible]
A.A. Leon Guerrero
Senior Vice President
General Administration

AALG:mdm

ACCEPTED BY: /s/[illegible] DATE: 9/25/85

EXHIBIT 2

SUPPLEMENTAL APPENDIX C

Bank of Guam

ANTHONY A. LEON GUERRERO
Executive Vice President/
Chief Operating Officer
[logo]

"The People's Bank"
MEMBER OF THE
FEDERAL DEPOSIT
INSURANCE CORP.

P.O. Box BW
Agana, Guam 96910
Tel: 472-8865/6/7

Only locally owned Bank – founded 1972 by Jesus S. Leon Guerrero

August 25, 1996 [Received AUG 26 1986]

Dave Santos
Director
Department of Revenue & Taxation
855 West Marine Drive
Agana, Guam 96910

Dear Dave:

Pursuant to our agreement of September 25, 1985 relative to the repayment schedule of the Bank of Guam income tax refunds, we hereby acknowledge receipt of the principal amounts in total. In lieu of the final payment for accrued interest, we hereby request that the amount be applied to our 1985 Corporate income tax return. A schedule reflecting the calculation will be attached to the return which will be filed on or about September 15, 1986.

Thank you for your assistance in this matter.

Sincerely,

/s/ [illegible]
A.A. LEON GUERRO
Executive Vice President
Chief Operating Office

AALG:mdm

Please acknowledge agreement

/s/ [illegible]

EXHIBIT 3